

MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 602
Indianapolis, Indiana 46204

August 21, 1997

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dwayne Isaacs
Teresa Ghilarducci
Steven Miller

OTHERS PRESENT

Mary Beth Braitman, Ice Miller Donadio & Ryan
Richard Boggs, Burnley Associates
Kris Ford, Mercer Investment Consulting
Kellie Scheurell, Mercer Investment Consulting
Robert Newland, Teachers' Retirement Fund
Garth Dickey, PERF Director
Patrick Lane, PERF Executive Assistant to the Director
William Hutchinson, PERF Division Director, Pension Administration
Linda Petro, Recording Secretary

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of August 21 & 22, 1997 Meeting
- B. Minutes of May 7 & 8, 1997 Meeting
- C. Statements of Retired and Disabled Members - PERF, Judges' Retirement System, Conservation & Excise, and Police & Fire

A quorum being present, the meeting was called to order.

1. INTRODUCTION OF NEW BOARD APPOINTEE

Steven Miller was introduced as the newest member of the Board, appointed to supersede Kyle Lanham whose term expired at the end of June. Mr. Miller is the current Treasurer at Indiana University and comes to the Board with 24 years of experience in industrial, financial service and academic institutions. Previous positions have included the Director of Fixed Income Marketing for Aetna Capital Management, Pension Trust Investment Manager for The Upjohn Company, and Corporate Credit Analyst for the National Bank of Detroit.

2. APPROVAL OF MINUTES

Following review by the Board,

MOTION duly made by Nancy Turner, seconded by Dwayne Isaacs and unanimously carried to approve the Minutes of the May 7 & 8, 1997 meeting.

3. INVESTMENTS MADE SINCE LAST MEETING

Garth Dickey updated the Board with respect to investments made since its last meeting. In May, an initial investment of \$300 million was made in the S&P 500 Index Fund, which is being administered by American National Bank. That was followed up with investments of \$100 million in June, July and August. Thus, there has been an incremental movement of \$600 million into the S&P 500. All of the investments made have taken place within the PERF fund itself, not in the other funds for which PERF is responsible. The goal is to move \$100 million per month for the next three years into the equities market and initially into the S&P 500 Index because it is a natural and relatively easy market to move into. It's also a market that has relatively low transactions costs. The execution costs for the last four monthly investments have averaged something below 2 cents per share. In terms of transactions costs, it's a matter right now of whether or not there are crossing opportunities. To date, futures have not been utilized at all.

4. RESTATED STATEMENT OF INVESTMENT POLICY

Presentation of Sections 5, 6, 7 & 8

Chairman Doermer noted that the Board had previously reviewed a number of sections of the Investment Policy. Those yet to be reviewed were Sections 5, 6, 7, and 8. After the Board's last meeting, the Investment Committee met to work on and review preliminary drafts to these sections. That meeting was adjourned and Mr. Dickey and the consultants worked further on Sections 7 and 8 with a subsequent conference phone call with the Investment Committee to review those sections further. As a result of all that a draft restatement was prepared, and copies of that draft were distributed to the Board for review at today's meeting (Exhibit A).

Mr. Dickey began the review and noted suggested changes to the sections as follows:

SECTION 5 - GENERAL OBJECTIVES

The investment activities are designed to provide a return on Fund **portfolio assets** that, when coupled with the periodic contributions of the membership and employers, will meet or exceed the benefit funding requirements of the Fund.

SECTION 6 - ASSET ALLOCATION

Selected Allocations - Strike the "Emerging International Equities" asset class and change allowable ranges as follows:

Large Cap Domestic Equities	25-35%	30-40%
Small Cap Domestic Equities	15-25%	10-20%

International Equities	0-10%	5-15%
Domestic Bonds	20-55%	25-55%

Within each asset class, the Board at their discretion may establish subclasses, such as “Growth” and “Value” equities, “Mortgage Backed Securities” and “~~Corporation~~” “**Corporate**” bonds, etc., and the Board also may establish the mix between active managers and passive index managers.

SECTION 7 - INVESTMENT PERFORMANCE STANDARDS

Performance Evaluation Factors for Total Fund

The key factors to be used . . . include:

- The progress on the benefit funding requirements of the Fund.
- Investment rate of return **and volatility** of the Fund, compared to a weighted average of broadly diversified **market** indexes which best describe the Fund’s asset classes and subclasses.
- Investment rate of return of the Fund, compared to other large private and public pension funds with special emphasis on comparisons with other large public funds.

Performance Evaluation Factors for Investment Managers

Following the paragraph which reads “Rates of return for a manager will be evaluated . . .”, add a separate paragraph to read:

Volatility will be measured by the standard deviation of the historical series of rates of return over a period of not less than three years.

Compliance with the Fund’s guidelines applicable to the particular asset class under management will be considered in the evaluation of the investment manager’s investment performance, as well as the consistency of each manager’s investment decisions in the context of its assigned style and the investment objectives of the Fund for that asset class **performance within its specific style.**

Performance Evaluation Standards

The following standards will be used **as a guideline** for the evaluation of the investment performance of the investment managers and the total Fund:

Time Periods

One year
Three years
Rolling three years
Five years
Rolling five years

Performance Standards

Gross of fee rate of return ranking at or above the median of an appropriate universe or style peer group of investment managers, **on a one, three, or rolling three year period.**

Net of fee rate of return exceeding an appropriate market index benchmark, **on a three, rolling three, five, and rolling five year period.**

Risk-adjusted net of fee rate of return exceeding an appropriate market index benchmark, **on a three, rolling three, five, and rolling five year period.**

Volatility consistent with the assigned asset class, and relative to the appropriate market index benchmark, **on a three, rolling three, five, and rolling five year period.**

SECTION 8 - INVESTMENT GUIDELINES

Before discussion of today's recommended changes, Mr. Dickey noted other changes which had previously been made to the former guidelines as follows:

General Guidelines for Investment Managers

- Specific Limitation on Holdings. The purchase of securities in any one non-governmental corporation shall be limited to an initial cost of 5% of the market value of a manager's portfolio. Through capital appreciation, no such holding should exceed 7.5% of the market value of the total holdings of such manager's portfolio. (Note: Just as a target and range have been set in asset allocation, there has long been a limit of 5% of a holding in any one name. In applying that old limit to the new asset classes, there was a definition established that securities of any one non-governmental corporation should not be more than 5% of market value. Then there was an effort to recognize the fact that sometimes things will go up in value. Here the target would be no more than 5% with 7.5% as the limit.)

- Proxy Voting - Each manager will abide by the Fund's Proxy Voting Policy as stated in Section 12 of this Statement. Each manager will provide an annual report of proxy voting activity to the Fund consistent with the requirements of Section 12. (Note: This section was added simply as a cross reference back to Section 12.)

Continuing with further recommended changes:

- Conflicts of Interest. An investment manager shall be subject to all the **applicable** provisions of Section 4 of this Statement. An investment manager
- Correction of Violations - In the event a violation of the guidelines occurs, unless otherwise approved by the Fund **Director** in writing, **based upon a determination of the best interest to the Fund**, the violation:
- ~~Indiana Investments - Whenever investment value, quality and return are expected to be equal to similar investment opportunities elsewhere, investment managers shall give consideration to the impact on the economic well-being of the State of Indiana and its residents in making their investment decisions.~~

Reporting Procedures for Investment Managers

The investment manager shall:

- Prepare a quarterly report to be delivered Periodically, the staff will provide the investment manager with a detailed description and format for these monthly reports.
- Immediately report all instances of economically material events which would affect investment performance **of securities held** (e.g., default missed interest payments, violation of bond covenants, or significant business restructuring) to the Board and provide recommendations regarding options for readdressing such issues, including withdrawing from the investment or other appropriate actions.
- Advise the Board immediately and in writing if any of the following events occur within the investment manager organizations:
 - a loss of one or more key people
 - a significant change in investment philosophy

- a new portfolio manager(s) or account **management manager** on the Fund's account
- a change in ownership or control (whether through acquisition, disposition, spin-off, merger, consolidation, or otherwise) or in business focus of the investment manager
- ~~loss of a significant client relationship~~ other events that would materially impact the investment manager's condition
significant client relationship loss
- any **other** event which could be judged to or deemed to adversely impact to a significant degree the management, professionalism, integrity or financial position of the investment manager

General Guidelines for the Investment of the Specific Portfolios

Generally, the structure of the Fund includes the following asset classes:

- domestic equity
- international equity
- domestic fixed income

Specific Guidelines for Domestic Equity Portfolios

- Core - Index
- Subclasscategory Description: Investment in a portfolio of stocks that substantially match the composition and characteristics, including return and standard deviation, of the market index benchmark. Futures may be used for the sole purpose of investing cash flows and may not be used to leverage the portfolio. (Note: This is the first and only time that derivatives in the form of futures would be allowed. The rationale being that in an effort to stay fully invested in the Index, a dividend check, in isolation, cannot be reinvested in the broadly defined universe of 500 stocks. Those can, however, be collected during the month and invested in S&P futures and the futures then collapsed at the end of the month and the Index again purchased.)
- Core - Enhanced Index
- Subclasscategory Description:

- Investment Constraints: The common stocks of companies other than those which comprise the index and listed on the major U.S. stock exchanges or traded on the NASDAQ are prohibited unless specifically approved by the Board.
- Capitalization **and Style** Specific Active Management
 - Subclasscategory Description: The Board intends to identify and select investment managers to **Investment** in subclassescategories of domestic equity divided by market capitalization ranges, as well as growth/value styles. This will be achieved
 - Investment Constraints: The common stocks (including ADRs) of companies other than those listed on the major U.S. stock exchanges or traded on the NASDAQ **national market (NM)** are prohibited unless specifically approved by the Board. The manager may never
 - Benchmark: The Board expects to hire active managers categorized by capitalization size, to manage against one or more of the following benchmark indexes: **Specific benchmark index as determined by the Board**:

Specific Guidelines for Domestic Fixed Income Portfolios

- Core-Index
 - Subclasscategory Description:
- Core-Enhanced Index
 - Subclasscategory Description:
 - Investment Constraints: Securities other than those specifically approved by the Board. No holdings in a

particular sector shall exceed ~~200%~~ of **two times** the index's weighted percent of holdings in such sector, as a percent of the total index's market value.

- Core-Active Management
 - Subclasscategory Description:
 - Investment Constraints: Securities other than those specifically approved by the Board. ~~No holdings in a particular sector shall exceed 150% of the index' percent of holding in such sector, as a percent of the total index's market value, without specific prior written approved of the Board.~~ **No portfolio may contain more than 40% mortgage securities, 60% corporate securities, or 10% securities rated "BAA" or "BBB". No portfolio may vary in duration by more than 20% above or below the duration of the benchmark index.**
- Sector or Maturity Specific Active Management
 - Subclasscategory Description:
 - Benchmark: The benchmark will be determined by the ~~Fund~~ **Board** based upon consistency with the sector or maturity focus of the investment subclasscategory. The benchmark will be selected from a list of well-known, industry-accepted bond market indices. ~~For example, an intermediate term broadly invested portfolio may have the Lehman Brothers Intermediate Aggregate Index as its benchmark.~~

Specific Guidelines for International Equity Portfolio

- Core-Index
 - Subclasscategory Description:
 - Benchmark: Strategies primarily consistent with a portfolio broadly invested in the countries in the EAFE Index will have as their benchmark the EAFE Index. Market specific strategies will use an MSCI regional or country index most consistent with their portfolio holdings, as determined by the **Fund Board**.

Mr. Dickey noted that the custodian and securities lending agent had come to him with comments on both Section 9, Guidelines for the Custodian, and Section 10, Securities Lending Policy. In that the Board had previously reviewed those sections, it was

determined that PERF's attorney would be relied upon for negotiation of those changes since they are technical matters.

The Board then turned its attention to the matter of immunity and insurance options with a complete discussion of the attached memorandum (Exhibit B).

5. ADJOURNMENT

The meeting was adjourned, to be reconvened at 8:30 on August 22.

MINUTES

BOARD OF TRUSTEES PUBLIC EMPLOYEES' RETIREMENT FUND 143 West Market Street, Suite 602 Indianapolis, Indiana 46204

August 22, 1997

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dwayne Isaacs
Teresa Ghilarducci
Steven Miller

OTHERS PRESENT

Diana Hamilton, Special Liaison to the Governor for Public Finance
Mary Beth Braitman, Ice Miller Donadio & Ryan
Richard Boggs, Burnley Associates
Kris Ford, Mercer Investment Consulting
Kellie Scheurell, Mercer Investment Consulting
Chuck Keaton, McCready & Keene, Inc.
Doug Todd, McCready & Keene, Inc.
Joe Thomas, McCready & Keene, Inc.
Elaine Beaty, McCready & Keene, Inc.
Leland Tanner, Prime Capital Management
Philip Barnes, Prime Capital Management
David Withrow, Prime Capital Management
Ed Feigenbaum, Indiana Legislative Insight
Garth Dickey, PERF Director
Patrick Lane, PERF Executive Assistant to the Director
William Hutchinson, PERF Division Director, Pension Administration
Dave Yeater, PERF Controller
Linda Petro, Recording Secretary

A quorum being present, the meeting was called to order.

1. REVIEW OF THE APPROVAL PROCESS FOR THE RESTATED STATEMENT OF INVESTMENT POLICY

Chairman Doermer noted that Sections 1-4 had been discussed at prior Board meetings. Before the policy is finalized, Sections 3 and 4 are to be expanded upon with additional

definitions and some clarification. The floor was then opened for discussion of any further recommended changes to Sections 5-15. Suggested changes included:

SECTION 4. CODE OF ETHICS

(Note: Discussion on this section was deferred until each Trustee had had an opportunity to review it in depth. Any recommended changes will be referred to Mary Beth Braitman following the Board meeting.)

SECTION 6. INVESTMENT RESTRICTIONS ASSET ALLOCATION

(Note: This change would simply provide consistency between the Table of Contents and the Section title itself.)

SECTION 8. INVESTMENT GUIDELINES

~~Errors and Omissions Insurance~~ **Fiduciary Insurance.** All managers will obtain ~~errors and omissions~~ **fiduciary** insurance coverage, in which the Fund is a named insured party, in such amount as required by the Board, ~~but such coverage shall be at least the greater of \$500,000 or 1% of the assets managed but not to exceed \$10,000,000;.~~ **Each Investment mManager** shall annually provide evidence in writing of the existence of such coverage.

Fidelity Bond. All managers will obtain fidelity bonds, in the amount of \$_____ million; as required by the Board. Each manager will be required to

SECTION 11. TRADING AND BROKERAGE POLICY

Review/Evaluation

At least annually, the Board will review all transactions ~~The brokerage firms~~ **investment managers and custodians** providing services shall provide any information necessary or helpful to this review.

SECTION 12. PROXY VOTING POLICY

Introduction

The Indiana Public Employees' Retirement Fund (Fund) The Board recognizes its responsibilities as ~~a~~ **fiduciaries fiduciary** of the Fund. The Board believes

Guidelines

In voting the proxies of common stocks, the manager The Board intends that this embody the most rigid **rigorous** application of this standard, that the manager act “with an eye solely to the best interests of the plan participants.” Leigh v. Engle.

Reporting Requirements

The Board intends to monitor To allow this to occur, each manager who votes shares of common stock will document such votes and report to the Board not less **frequently** than annually.

The report shall include at least **a minimum** the following:

- A description of actions in terms of any effects on **participants and their beneficiaries**, the Indiana economy, and any special Indiana issues. ,and members of the Fund

SECTION 13. PROCEDURES FOR EVALUATION AND REVIEW OF INVESTMENT MANAGERS

Meetings and Reports

The investment manager(s) are expected to meet The custodian is expected to meet at least annually **with the Board or its representative** to review its responsibilities. Investment managers are also expected to meet regularly with Staff to review the portfolio.

SECTION 14. STANDARDS FOR THE SELECTION OF INVESTMENT MANAGERS, ADVISORS CONSULTANTS, AND CUSTODIANS

The Board realizes The Board expects to retain custodians, investment managers and investment advisors **consultants** to provide such assistance. Each such entity **selectinged** will serve as a fiduciary to the Fund.

SECTION 15. ~~SOCIAL~~ INVESTING TARGETED-INVESTMENT POLICY

Following the discussion of these recommended changes, the Board determined that the complete Policy would be retyped and distributed to the Trustees for review and finalization during a teleconference meeting on September 12.

2. REVIEW OF THE SEARCH PROCESS FOR THE ENHANCED INDEX AND SMALL CAPITALIZATION SEARCHES

Kris Ford noted that the intention is to combine the legal process with an analytical process on the part of PERF's consultants and Director. The proposed search process would follow these steps with the provision that the Director be allowed authority to further define operational and analytical processes in the preparation of reports and analysis of responses:

- a. Board approval for the role sought as defined by the Statement of Investment Policy
- b. Issuance of a Broad Agency Announcement ("BAA")
- c. Analysis of responses by the consultants with the advice of the Director
- d. Preparation of a report and recommendations by the consultants with the advice of the Director
- e. Presentation of the report and recommendations to the Investment Committee
- f. Interviews of candidates by the consultants, Director and Investment Committee
- g. Site visits by the Director and Investment Committee to selected finalist candidates
- h. Presentation of finalist candidates to the Board for selection and approval

Following some discussion,

MOTION duly made by Steven Miller, seconded by Nancy Turner and unanimously carried to approve the search process as described. Additionally, PERF's Director is to begin the searches and report back on the progress at the next Board meeting.

3. ACTUARIAL PRESENTATION

Chuck Keaton, Doug Todd, Joe Thomas and Elaine Beaty were in attendance representing McCready & Keene.

Mr. Todd opened the discussion which concerned police and fire assumptions. Historically, before 1977 there were police and fire pension plans in the State of Indiana, but they were unfunded (pay-as-you-go) plans. That was recognized as being a sizeable burden, so in 1977 a new prefunded plan was established for individuals hired in 1977 and thereafter. There were some special provisions which allowed for transfer from the old plan to the new. Following an actuarial evaluation, a total contribution rate of 27% was established (21% employer contribution and 6% employee contribution). Looking at the actual computed employer contributions from 1980 to 1997, there was a high of 25.2% and a low of 23.3%. Thus, the assumptions chosen when the plan was established were good in total. However, one of the concerns that has been growing concerns that assumptions when you look at them individually. There are two primary assumptions which are out of line --- the interest rate return and the mortality table. The 21% has always been based on a rate of return of 6%, which currently seems a little low. Additionally, the mortality has been based on 1969-71 U.S. Life tables. More recent mortality tables are based on the 1983 GAM ("Group Annuity Mortality") tables. Finally, currently assets, for funding purposes, are valued at the lesser of market value or amortized cost. There is a new accounting rule (GASB #27) which now requires actual costs, for disclosure purposes, to be done on a market value basis. Thus, it was felt that this was a good time to look at making some actuarial methods and assumption changes.

Looking at the study completed by McCready, the January 1, 1996 actuarial valuation was revalued with adjusted actuarial assumptions. Different interest rates were used and, in some instances, mortality was changed to the 1983 GAM tables. All figures also reflected a change in the Asset Valuation Method to a 4-Year Average Market Basis. The results indicated that if only the mortality table was changed, there would be an increase in the employer contribution rate to 54.9%. If only the interest rate was changed, the employer contribution rate would be as follows:

<u>Interest Rate</u>	<u>Employer Contribution Rate</u>
7.00%	12.1%
7.25%	9.6%
7.50%	7.2%

Mixing the two and changing the interest rate and the mortality table, the employer contribution rate would be as follows:

<u>Interest Rate</u>	<u>Employer Contribution Rate</u>
7.00%	18.2%
7.25%	15.3%
7.50%	12.5%

Mr. Dickey noted that it was incumbent upon the Trustees, and the actuaries would feel more comfortable, should the Board use the most reasonable and widely accepted and appropriate mortality table.

We've had a change in circumstances where we can reasonably expect to have higher returns in the future. Whether or not we should adopt, and how far we should go in adopting, a higher portfolio return assumption prior to actually realizing it is the question. While we did this study looking at numbers of 7.00%, 7.25%, and 7.50%, I should quickly point out that that's reflective of where we are with PERF. We may want to consider going from the current assumption of 6% to, say, 6.50% or to move that assumption up over a period of time and continue to review it. We could set forth an action of moving from 6.00% to 6.50% to 7.00% to 7.50% over the next few years and still accomplish a desirable goal of maintaining a level of stability in the employer contribution rates.

Mr. Keaton added that from the standpoint of this being the 1977 plan, the first individuals who can retire (someone with 20 year of service) will be people who were hired in April or May of 1977.

A lot of people have felt from the start that there would be pressures once this 20 year period passed to change the retirement age. In fact, that kind of a bill has been submitted (to the Legislature) from time to time, and it's not gone anywhere. The distinction I would like to draw, therefore, is the distinction between our moving to more modern, explicit assumptions to what is adopted as a contribution rate. We have continued to recommend 21% even though our calculated contribution rate has oscillated around that. However, I'm sure that what's in someone's mind out there is that they want to continue to contribute 21% and improve their retirement age as the funding situation will allow. It seems to me it is not irrational to consider literalizing the assumptions to some degree in coordination with that kind of a initiative.

Mr. Dickey continued that the Board is not in the business of setting police and fire benefits --- it's up to the Legislature. But the Legislature will always turn to PERF and ask what the cost would be. In the past pressures to change the benefits have not gone forward largely because of the cost. "So, what you're hearing here is a note of caution. There will be continued pressures, and it may be advisable for us to consider a phasing-in approach, or at least a preliminary step in that direction."

Following further discussion,

MOTION duly made by Dwayne Isaacs, seconded by Nancy Turner and unanimously carried to change the asset valuation method to a 4-year average market, increase the assumed investment return to 6.75%, and to adopt the 1983 Group Annuity Mortality ("GAM") tables.

4. INVESTMENTS

Burnley Associates, Inc.

Richard Boggs was in attendance representing Burnley Associates, Inc.

Mr. Boggs began that the stock market through June was up 20%. Growth was still leading the market (up 32%), and value was up around 24%. Those numbers are tremendous for the stock market. In 1995 it was up 37%, last year it was up 23%, and year-to-date through August 21 it was up 28%. Inflation was holding on an annualized basis.

The bond market through June was up 3.1%. To the extent that mortgage backed securities and corporates were emphasized in managers' portfolios, those that were over concentrated

tended to do better than those managers who weren't. Thus, not only was duration an issue, but also the over weighting of mortgage backs and corporates.

Looking at the total plan, the Fund was up 3.7% during the quarter. The \$400 million investment in equities during that period added .2% incrementally to performance --- thus, the plan would have been up 3.5% had it not been for that contribution from the equity markets. The total fund hovered very closely right around the LBA. Some things happened during the quarter which were significant. One of them was that cash was decreased from 8% to 3%. However, a lot of that 8% was in anticipation of the stock market allocation. That's the reason the duration appears to have been 4.38% at the beginning of the quarter. It wasn't that there was some massive shifts in the managers strategies.

With respect to the 50/50 managers, Bank One fell well behind the benchmark this year as they did, in fact, last year. In 1996, they were on the wrong side of the duration bet, they were long when they should have been short. In the first quarter of 1997 they were a little bit long when they should have been short, and in the second quarter they should have been longer. Over the last 2-1/2 years they have consistently done the wrong thing. They indicate that as a matter of internal policy, retrospectively, they have recognized that they have perhaps made duration bets that were too large, and they have seriously curtailed anyduration bets they will make. Mr. Dickey added that Bank One was one of the two managers with whom he and Mr. Boggs met prior to the Board meeting.

Not to try to defend them unduly, but to reflect properly on what we heard yesterday, they are not doing poorly just in our portfolio. What they are talking about in terms of reducing the duration bets they make and limiting themselves more and focusing more on their sector selection is an across-the-board approach. They've had better performances in other portfolios when they have not had the same constraints that we put on them and when they haven't been managing against our 50/50 Index but rather managing against the LBA. Bear in mind, that a year ago we took away \$250 million, so it's not as though we have passively sat back and suffered with poor performance without engaging in monitoring and discussion with them. So it's well documented that we are taking an active interest in what they're doing.

Mr. Boggs continued that the other manager who suffered from underperformance this year was HM Capital. That is fairly easily explained by the their short duration and use of virtually all treasuries. The good job was done by Reams Asset Management. It's hard to target a single reason for that except, perhaps, for the over weighting of corporates. If you look at their duration, it was actually short. However, they tied the index in a quarter where they had a short duration. They have been consistently, in this category, one of the best managers.

Looking at the LBA managers year-to-date, only six of the ten managers have exceeded the LBA net of fees. Conspicuously on the good side year-to-date and cumulatively over long periods of time has been Consecro. One of the things they have done is to consistently overweight the corporate sector. Another manager who did well in 1996 and 1997 is Taplin

Canada, and yet their cumulative numbers look very poor. Part of that is because the Fund, in 1995, was reallocating, and Taplin was given cash during the middle of a rally. They sat on the cash which hurt their cumulative numbers. However, prior to that and since then they have done an extremely good job.

Hughes Capital Manager was the second of the two managers interviewed by Mr. Boggs and Mr. Dickey prior to the Board meeting. Mr. Boggs noted that he could not really determine why they had under performed this year ---- it seemed to be an accumulation of several little things rather than anything specific. Mr. Dickey added that there was a demonstrative difference between the two managers earlier interviewed.

In the case of Bank One, they had bad performance in the past, but they talked constructively about why, what they were doing and how they are changing their process. In the case of Hughes, I certainly didn't feel like they had any explanation for the bad performance. More tellingly, there was no reason for us to believe that their bad performance won't continue.

Mr. Boggs then summarized Prime Capital's performance and noted that they had the lowest return of any of the managers year-to-date. The reason for that is they were consistently this year, as they were last year, on the wrong side of duration bets. They have in the past been the Fund's single best manager, and their fee is almost negligible. Over four years they tied the LBA, over five years they exceeded it by 30 basis points, and jumping out to ten years they exceeded by 30 basis points.

Concerning securities lending, National City/Chase had a 70% efficiency ratio of having on loan securities that the Investment Guidelines would have permitted, and Bank One had a 78% ratio. Comparing the two and in the absence of other circumstances, Bank One seemed to be a little more efficient as a lender of what could have been loaned out during the quarter. Income generated from securities lending during the first six months was running \$1.4 million for National City/Chase and \$300 thousand for Bank One, the equivalent to that generated last year in both portfolios. That income more than offsets the custody fees.

Concerning allocations, the \$100 million per month equity investments are coming out of the Reallocation Fund (old LBA -5 Index Fund). At the end of June such transfers into stocks totaled \$600 million. There have been deductions of \$600 million to date, and after the three \$100 million investments to be made for September, October, and November, that fund will pretty well be depleted. It is Burnley's recommendation that the Board proceed on an as-needed basis to take additional monies out of the 50/50 Index Fund. The intent has been to take money from some of the fixed income passive indexing funds and move it into equity passive indexing on a regular basis. Down the road there will be the need to look at other sources, but for the moment there are two index funds (aside from the basic LBA Index Fund) which could be used.

MOTION duly made by Steven Miller, seconded by Teresa Ghilarducci and unanimously carried to use the 50/50 Index Fund as a backup to the LBA -5 for the continued funding of equity investments. Additionally, the Director will work with the Investment Committee to present a longer term termination/reallocation transition plan with respect to the fixed

income managers.

Prime Capital Management

Leland Tanner, Philip Barnes, and David Withrow were in attendance representing Prime Capital Management.

Mr. Tanner began his report with a review of the markets. In 1993, the market was down all year. The year began yielding almost 7.5%, but declined to a low of 5.78% in October, and at year-end they were 6.35%. Prime had a long portfolio in 1993 --- they were approximately 110%-120% duration of the index. The following year was the exact opposite beginning with the Fed starting a long tightening process. The 30 year treasury reached the low yield early in the year at 6.17% and steadily increased to an 8% yield in November. When the Fed started tightening, Prime shortened their duration and were at about 90% of the duration for most of year. In 1995, the trend was downward in yield. The bull market began the year yielding close to 8% and declined all year steadily and ended at 5.95% at the end of December. Prime, early in the year, made a decision to go long because they felt that the market was going to do better. Thus, Prime had three good years in a row. Then in 1996, the Fed tightened again in January and things looked as though they were going to be pretty good. However, there was clearly no real trend, increasing from 5.95% in January to 7.20% in June, falling to 6.35% in November and then ending the year at 6.65%. It was a year when all money managers had a tough time. As a result of that volatility and difficulty in correctly predicting the market direction, many managers either became closet indexers with the LBA or became credit risk managers rather than duration managers. So far in 1997 that volatility and a lack of trend has continued. The year began with a long treasury yielding 6.65% and went to 6.50% in February. It then retreated to 7.15% in April and fell to 6.30% on July 31 and again began moving upward. The total rate of return for the LBA Index was 2.70% which was the highest return since May of 1995. The LBA yields on 5, 10, and 30 year treasuries fell by almost 50 basis points. Prime's performance exceeded the index by 36 basis points because they, in June, took a more positive position in the market.

Looking specifically at the PERF portfolio, Prime was under weighted in the under 3 year area by over 22%. They had an overweight in 3-5 years at 13%, an overweight in the 5-7 years of 12.5%, they were under weighted in the 7-15 years at 12-13%, and their over 15 year was overweighted by 9.3%. Their duration was about 112 of the duration of the index. So they were in a more bullish mode than a defensive mode. Looking at their U.S. Treasury holdings, they were pretty close to the index rating. They have increased their finance position from under 20% to 26% of the portfolio, and that's an overweight of 20%. They do not have any industrial or utility holdings in the portfolio. They feel there are risks in industrials because of potential buy outs, and an "A" rated bond could very well go to "BAA" or less in a buy out. They have also avoided utilities because they are going to become very competitive in the future.

Prime was basically index weighted in mortgage backed securities with one major difference, that being that all their mortgage backs are either 15 years or balloons. That gives them less interest rate convexity risk. Their mortgage portfolio is not going to lengthen or shorten as much as a 30 year mortgage held by other managers, and Prime feels that they can better manage their risk by having a short term anchor. All their finance

paper is in the 5-7 year maturity range because they feel that's where the value occurs. The long bond commitment they have are all U.S. Treasuries (22%). That's where Prime has made their interest rate bet. They feel that's the place to be because if the market does have a nice run, they will feel the positive effect of that.

In summary, Prime's portfolio duration is expected to maintain 110-115% of the index. They are going to be an aggressive investor, increasing their 5-7 year maturity finance holdings to 26% of the portfolio (they were 20%), treasuries will be reduced from 50% to 40%, they are going to maintain their short term mortgage position, and if there is a back up in yields, they will increase their position in long-term treasuries.

5. UNITIZATION OF PENSION FUNDS

Mr. Dickey explained to the Board that there is a need to unitize how the various pension funds are approached and use a unit trust structure. In the PERF fund alone there was about a 20 basis point pickup as a result of the Fund's movement into equities. There is a lot of money in the other PERF-administered funds that is not benefiting from the move into equities. What he proposed was to consolidate the custodial relationship into a single custodian and move to a unit trust accounting, perhaps even on a retroactive basis to the first of the fiscal year. That would provide the benefit of spreading the performance of all the managers across all the portfolios. The portfolios that would not be affected would be the Legislators' Defined Contribution Plan and the Pension Relief Fund.

Following discussion,

MOTION duly made by Steven Miller, seconded by Dwayne Isaacs, and unanimously carried to authorize the Director to proceed with the unitization of the various pension funds and to report back to the Board on the matter.

6. ADMINISTRATIVE MATTERS

Status of Outside Audit

The Request for Proposal ("RFP") for an outside audit has yet to be issued, but has, however, been finalized. Mr. Dickey noted that hopefully by the next Board meeting the RFP will have been issued, a firm selected and the audit completed.

Building Manager Update

The new building manager (Mathews-Click-Revel & Henry) have been doing a good job. A new tenant for the second property at 125 West Market has been secured. They are currently in the building. That property, which was vacant for years, now has 100% occupancy. The building was renovated a bit, and PERF is getting market rate on the space at about \$12 per foot gross of expenses.

With respect to the 143 West Market Street building, the Director is currently in negotiation with the existing tenants on the 7th floor about moving them to the 3rd floor which is vacant. The building manager has been collecting quotes. It has been proposed to the current 7th floor tenants that they will be relocated under their existing leases and a nice space made for them on the 3rd floor. That, in turn, would open up the 7th floor and give PERF more space should approval be given to add to staff.

Quarterly Financial Report

Dave Yeater, PERF Controller, distributed to the Trustees a quarterly financial report (Exhibit C) for review. He reported that there was a \$536,00 variance due to the fact that one of the parties under contract to PERF had yet to submit a total bill for their services. Thus, there was money yet to be spent which was not reflected in the report.

Quality Management

Bill Hutchinson, PERF Division Director of Pension Administration, reported that the Fund now has a set of management reports which were run on two functions, the preparation of estimates and retirements.

The reports indicate that over a 5-1/2 month period there were 1,136 estimates prepared. Currently, estimates are given to individuals who are within one year of being eligible for retirement, and they are given one time per year only. The two chief impediments to doing estimates at the touch of a button are the lack of adequate information on the IRIS system as regards both salaries and service prior to 1987. IRIS was constructed to figure estimates under the old high five rule, which is the five highest years, whereas now the high five rule utilizes the five highest groups of four continuous quarters. Thus, high fives are being calculated by hand as well as the certification of salary and service information. The management reports indicated that to get 50% of the estimate requests completed takes 21 days and 71 days to complete 90% of the requests. The situation with retirements is essentially the same. To complete 50% of retirements is taking 61 days and 100 days to complete 90%.

Mr. Dickey noted that PERF has initiated a total quality management model in an effort to maximize the effectiveness of staff in all functional areas. The various committees are comprised of the general staff and do not include any management personnel. They are discussing what needs to be done to improve customer service, simplification of internal procedures and revision/improvement of forms. This will be an ongoing process with the committees identifying problems, making suggestions, and the management personnel will then review those identified problems and suggested solutions and make a determination. It is hoped that this will continue to have benefits in terms of employee morale as well as functionally helping to identify things which can be improved.

New Units & Enlargements

MOTION duly made by Nancy Turner, seconded by Steven Miller and unanimously carried to approve the following new unit:

1668 - Town of New Ross

7. NEXT MEETING DATE

By common consent, the next meeting of the Board of Trustees was set for November 17 & 18, 1997.

8. ADJOURNMENT

There being no further business, a Motion to adjourn was entertained, and by unanimous vote, the meeting was adjourned.

Richard T. Doermer
Chairman

H. Garth Dickey
Director